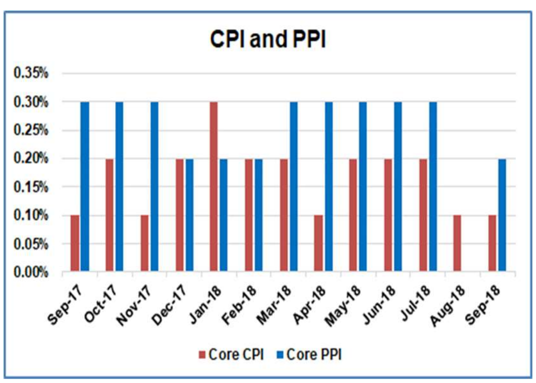
ECONOCAST WEEKLY

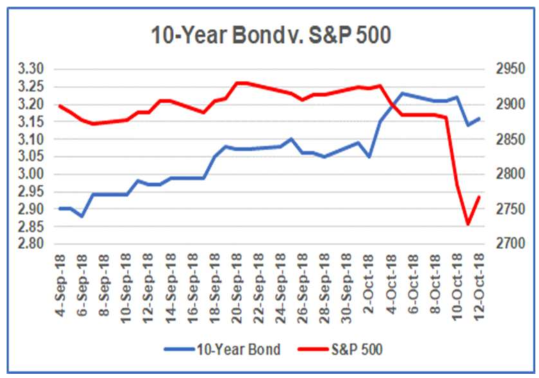
ECONOCAST™ UPDATE – October 15, 2018

U.S. Economy – Inflation Cools for Now and Markets Stabilized

The inflation reports for September were surprisingly low. This eased financial market concerns that the Fed would boost rates even more aggressively. The CPI rose 0.1% in September. Food prices were unchanged while energy CPI fell 0.5%. Core CPI rose just 0.1% in each of the last two months. September's PPI reinforced this view that inflation remains under control. The PPI for final demand rose 0.2% and core PPI has increased on average by 0.1% over the last two months.



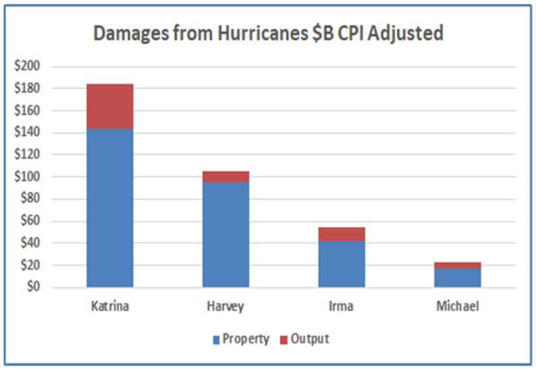
As a result, financial markets stabilized at the end of the week after falling sharply. Since September 4th the 10-Year Bond has increased by 26 bps and the S&P is down 4%. With inflation remaining within the Fed's target range, there is every reason to expect the Fed to continue to increase the funds rate once per quarter with the next bump in December.



The big question is whether the Fed can achieve the always illusive soft landing by slowly raising rates? A surge in inflation is unlikely to come from the labor market. Despite the tight conditions, wages continue rising modestly and overtime hours are up only slightly. Instead, reminiscent of the 1990s higher inflation producing more aggressive Fed action, will likely come from a combination of higher oil prices and more widespread use of tariffs. These are already bleeding into transportation costs and goods prices. President Trump calling the Fed "crazy" also does not help.

Florida Economy: Hurricane Michael to Cost $25 Billion

Hurricane Michael killed at least 16 people, and it will be one of the ten most costly U.S. hurricanes with damages of $15-to-$21 billion according to Moody's Economy.Com. My estimate is even higher at $25 billion, based on the devastating damage to most property in Mexico Beach and in Bay County along with the virtual destruction of Tyndall Air Force Base.

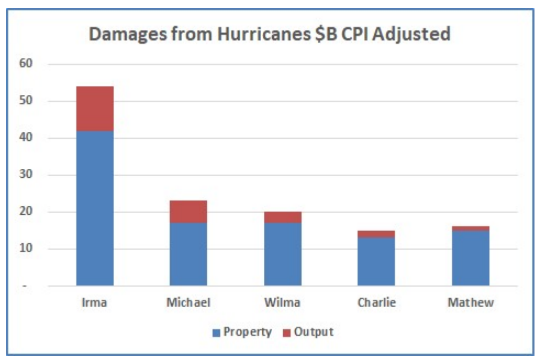


Unlike Irma and Florence which were very large storms that impacted huge swaths of Florida and the Southeast, Michael was relatively compact – but it was far more powerful with its Category 4 winds and storm surge.

Most of Michael's direct economic damage is to residential property which is likely to be insured against wind damage. Florida relies on dozens of insurance companies who are required to have high reinsurance requirements and high coverage levels. This will limit some of the direct economic damage, and it will boost reconstruction. However, there are reports of extensive flooding from storm surge, and these losses are less likely to be insured.

The impact area from Apalachicola to St. George Island has a fragile economy based largely on tourism, agriculture, forestry and fishing. North of the coast the area is largely rural. As a result, the economic recovery will be very slow.

Furthermore, the larger area's economy – from Bay County north through Georgia and the Carolinas will be disrupted for many weeks. Power and communication infrastructure will not be fully restored in Bay County and in rural areas to the north for at least 4 weeks. Damage to roadways and utilities is massive. The area's tourism and agricultural economic base will be very slow to recover. Many tourist facilities will be closed for at least a year, and many will never re-open based on the recent experience in the Keys. There was extensive damage to agriculture too. Georgia officials estimate over $1 billion in damage to chicken houses, along with massive losses to cotton and pecan crops.



The recent increase in hurricane frequency and intensity will boost property insurance rates in Florida and across the country. Over the next ten years rates will rise sufficiently to begin to affect the market value of coastal real estate in Florida. This will have significant consequential impacts on development activity and on property tax revenues in Florida.